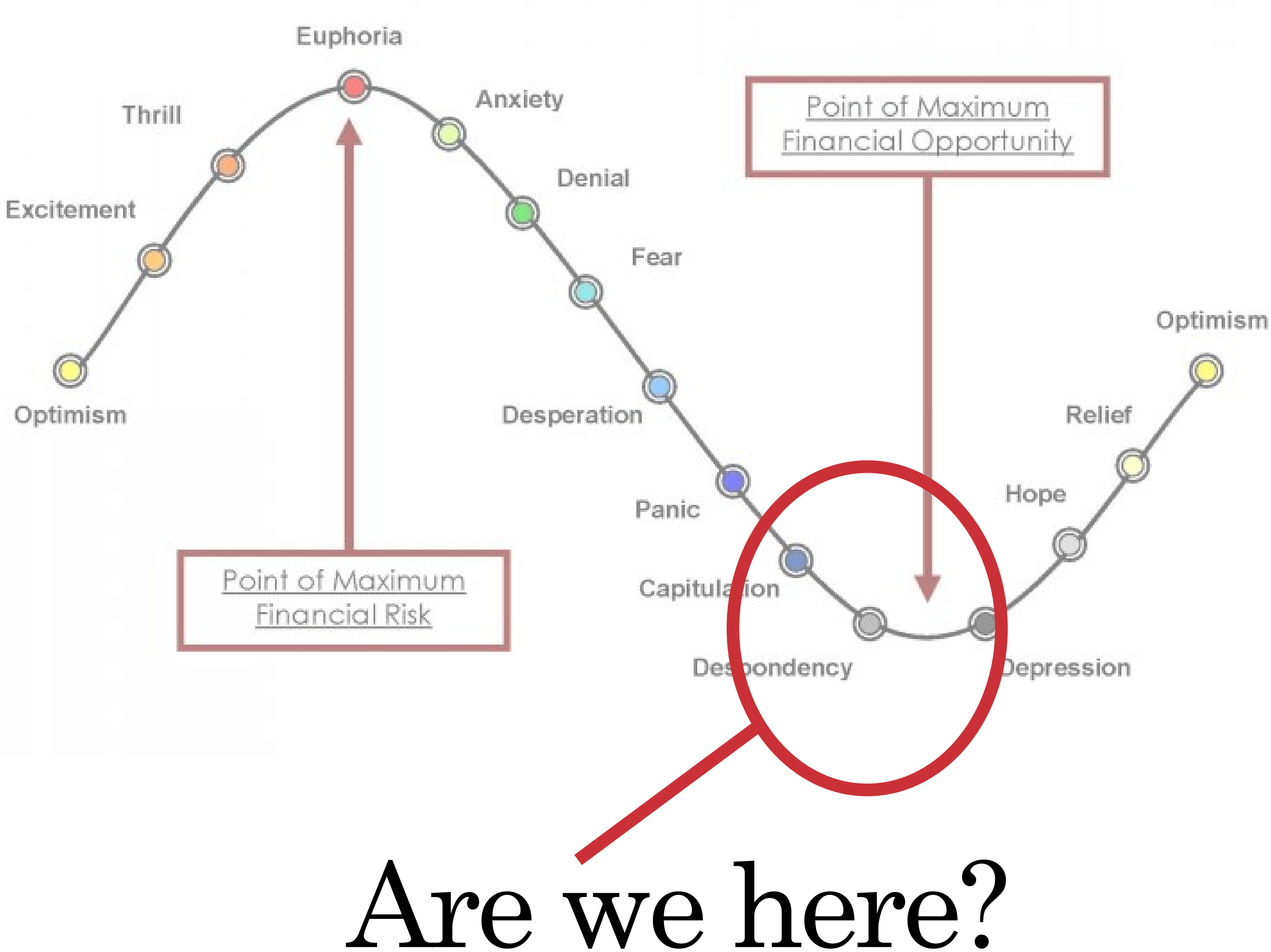
NAVIGATOR

WESTSHORE'S MONTHLY NORTH SEA REPORT
May 2015 Issue: 45



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Has the downturn bottomed out?

Brent Crude is edging nearer $70 a barrel, said by some to be 'The New $100'. Big Oil released first quarter results this month and the message to shareholders was that the worst was over. Oil prices are more likely to rise than fall while costs have been slashed. Though profits were down for most, analyst expectations were beaten and in the case of ConocoPhillips – the dividend was raised.

So what stage on the cycle of market emotions have we reached? If history is anything to go by, the big deals really get going when the market reaches its lowest point. A big deal such as Shell acquiring BG perhaps.

For those of us in the vessel sector the impact on rates wasn't immediately felt when the rumblings of discontent from oil companies started. That was further down the line, as one might expect – the demand for our services IS further down the line. But the take home message from the Navigator this month is this, back up the chain the clouds are clearing, things are picking up. This month's issue delves into this a little deeper but our belief is that it will take time before the positive impact reaches offshore support. But if the graph on the cover is anything to go by, the only way is up right?

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AVERAGE SPOT MARKET RATE AHTS

66.0%

Average AHTS utilisation in April

58.1%

Average PSV utilisation in April

	March 2014	April 2014	March 2015	April 2015
Number of supply spot fixtures	68	63	93	84
Number of AHTS fixures	64	92	72	62

25

Rig moves in April (compared to 31 in April 2014)

28

Rig moves in March (compared to 20 in march 2014)

AVERAGE SPOT MARKET RATE PSV

Another tough month on the North Sea spot market although some fared worse than others. By far the hardest hit in April was the UK-based PSV tonnage. A growing list of vessels returning from term commitments and occasionally new deliveries from yard have added to the oversupply situation. Meanwhile the number of fixtures, though still up on the same period last year, has shown a steady decline each month this year. This may be attributable to the increased focus from charterers to cut costs, both in terms of day rate paid to vessels and also the number of vessels it needs to have on hire. Cost cutting has been a huge focus for North Sea operators this year and pressure from management and shareholders has ensured that severe spending cuts have been ruthlessly carried out. The result for the PSV sector at least was a utilization hovering around 60% for most of the month and rates falling lower and lower.

The AHTS could have in theory fared better than it did rate-wise at least. For the Norwegian market utilization was up on the previous month, not due to increased fixing activity – this was down around 15% on the previous month. Vessels leaving the market for lay-up was partly attributable for the increase in utilization but poor sentiment (i.e. low confidence) is plaguing the market. When the market tightened what would have previously been an opportunity for owners to push rates up was not realized. Though cost cutting is an ever present issue at the moment, fixing vessels below breakeven is totally unsustainable – even charterers would agree.

SHELL AND BG
THE BIGGEST DEAL IN A DECADE WHO'S NEXT?

Months ago when the doom and gloom headlines for the oil industry really started to ramp up, talk of mergers and acquisitions was the hot topic. Yet the months went by, the oil price continued to flounder but no game changing aquisitions were announced, nobody has the money to do any buying it was said. Then Shell announced its $70bn deal to buy up the UK's third largest energy company BG. This propels it to the position of the world's third largest gas company with a market cap second only to ExxonMobil of all western oil companies.

It's true that funds are scarce and companies across the industry have an acute focus on cost cutting at the moment. But far from this being a deterrent in acquiring other companies, the BG Shell aquisition illustrates the point why a marriage like this is a cheaper way to navigate through the current crisis. Shell's reserves are boosted by a quarter following the deal, that means that buying up even expensively priced assets can work out cheaper than going out and finding and developing them yourself.

BRAZIL

This is particularly the case in Brazil where Shell will now take pole position as largest foreign oil company in the region with involvement in amongst other areas the giant Libra field. For BG, Brazil would account for a third of its production by 2020 but with Petrobras embroiled in a corruption scandal BG was struggling to maintain dialogue with the Brazilian giant. The deal is hoped to shed a new angle on this pressing problem with Petrobras. Shell has far greater financial and leverage capacity to undertake projects in Brazil which could potentially aid in some of Petrobras' financial woes. "Shell has more patience and financial strength," Juan Ramon Fernandez Arribas, an independent analyst based in Madrid, said in an e-mail. "It can wait more to develop its projects and is a more solid operator than BG. That's a big advantage in the discussions with Petrobras."

JUST THE BEGINNING

This aquisition places ExxonMobil and Shell as the top two companies in the sector with other companies trailing some way behind and beginning to look like niche players. In the North Sea in particular there's a plethora of smaller independents now struggling to cope with the pressure of the lower oil price. Consolidation is almost a given here but the problem is consolidating two small, underfunded companies just gives you one bigger underfunded company. A bigger move is inevitable, perhaps as a result of necessity if companies whose troubles take them to breaking point. As ever cash is king, those that have the money to pick up the spoils of those less fortunate will do so.

So which names top the bookies' list? EnQuest and Tullow Oil, ripe for the picking? Potential buyers – The Chinese, ExxonMobil, Total – all possibilities. Otherwise ENI could be a target. The coming together of two companies, integration of company culture is always an issue but marrying ENI's Italian ways to anything foreign could put many buyers off. Premier Oil was subject of a takeover bid for a third time recently by Ophir Energy. Though the deal failed to go through, Ophir is expected to seek alternatives – or become a target itself. For long enough it wasn't BG that was subject of acquisition speculation but its larger UK counterpart BP. ExxonMobil may be circling but the UK Government has stated that it will oppose any attempt at a foreign takeover. Analysts agree that BP is vulnerable to takeover but the current position from management is that they are against any mega-merger.

However most would agree consolidation and a wave of mergers will now set the scene for the coming years.

MORE LAYUPS WITH LITTLE IMPACT

The average rate for a PSV on the spot market this month fell to GBP 3220. That's the lowest in several years. Moreover while we have seen dips in rates before, this is surely the most prolonged downturn that the market has seen since the 80s. Adding insult to injury is the fact that very little light at the end of the tunnel is expected. This dire prognosis has led several owners to take the step of putting vessels into layup. French owner Bourbon announced that 23 of its fleet were currently in layup during its first quarter results release. Eidesvik took Viking Nereus, which had been trading the spot on the UK sector, out of the market and is currently tied up in Norway. UP Agate and UP Jasper also on the British side met a similar fate at the end of April. Maersk Supply announced that Maersk Shipper and Tackler would head to Invergordon as day rates reached "unrealistically low" levels according to management. Siem Aquamarine has left the market despite the fact it was one of the more reluctant owners to take this step up until now. Most if not all owners are saying more can and will follow.

The worst hit area of the spot market is UK based PSV tonnage. A quick survey revealed to us that curiously owners with vessels in this market are the most reluctant to lay up tonnage. A combination of company culture and ownership (i.e. not stock listed) and crew nationalities has resulted in the decision to ride out the storm as best they can avoiding any layup. And of course this just prolongs the downturn.

There are several term charters yet to be concluded which may be giving owners a sense of hope that work can be found. But it's silly to think that the amount of tonnage will come anywhere close to be soaked up by term requirements. Realistically the stream of vessels heading into layup will pick up as we move into the second half of this year. Meanwhile one of the intended benefits of sending a vessel into layup – i.e. an improvement in the market, has yet to be seen at all. In our opinion it's going to take another 15-20 PSVs disappearing from the spot market AND a leap in owner's confidence levels before rates take a turn for the better.

VESSELS CURRENTLY IN LAYUP

Name	Type	Owner
Far Sagaris	AHTS	Farstad
Maersk Shipper	AHTS	Maersk Supply
Maersk Tackler	AHTS	Maersk Supply
Normand Skarven	AHTS	Solstad
Normand Jarl	AHTS	Solstad
Siem Aquamarine	AHTS	Siem Offshore
Stril Commander	AHTS	Møkster
Strilborg	AHTS	Møkster
Bourbon Pearl	MPSV	Bourbon
Toisa Voyager	MPSV	Sealion
Bourbon Clear	PSV	Bourbon
Eide Traveler	PSV	Eide Marine
Far Superior	PSV	Farstad
Grimshader	PSV	COG Offshore
Island Duchess	PSV	Island Offshore
Island Duke	PSV	Island Offshore
Northern Support	PSV	DeepOcean Shipping
NSO Champion	PSV	Nor Supply
NSO Fortune	PSV	Nor Supply
NSO Spirit	PSV	Nor Supply
Ocean Scout	PSV	Atlantic Offshore
Rem Provider	PSV	Rem Offshore
Rem Star	PSV	Rem Offshore
Sea Trout	PSV	DESS
Skandi Fjord	PSV	DOF
Toisa Envoy	PSV	Sealion
UP Agate	PSV	Ultrapetrol
UP Jasper	PSV	Ultrapetrol
Viking Nereus	PSV	Eidesvik

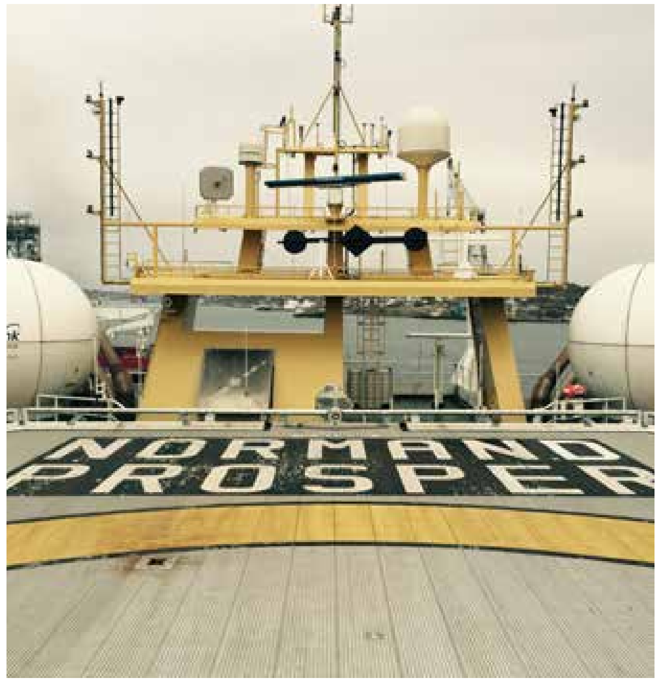
WHAT'S IN STORE FROM FIRST QUARTER RESULTS

Stock listed offshore owners are currently preparing for the release of their first quarter results. It's no secret that it's been a tough market this past year but to what extent is soon to be revealed. The spot market has continued its downward spiral particularly for the PSVs with rates below breakeven for the majority of vessels. On the term market owners face fierce competition for the reduced number of term tenders out and those with term charters in place are having to renegotiate rates sometimes on a monthly basis. Undeclared options are being unused or taken up at for less and less each option.

Good contract coverage constitutes the key strength for owners right now. Those that have locked in work for their vessels look good on paper, but in reality renegotiation of those contracts for lower daily hire is a very pressing reality. Finance is not expected to be a huge issue for the first half of this year but obligations to refinance loans and existing bonds will become a growing problem for owners as we creep into 2016 and onwards. This is something that will ultimately result in make or break for some companies.

A THANKYOU TO.....

This month some of our brokers paid a visit to vessels in port. We would like to thank the crew aboard Skandi Iceman, particularly Master Alan Troup for the tour of the vessel and hospitality while on board. Also the Normand Prosper, captain Olav Østbø and crew. Lastly Rem Stadt for taking time to show the vessel while we were in Bergen.



RIG TENDERS PICK UP

Encouraging signs of some real rig requirements have come from Talisman as well abandonment in the UK sector will require a rig for a two year contract commencing early 2016 and another for a one plus one year contract starting later in 2016. This is one of the few long term requirements that have come out for rigs in the past six months. Predictably a high number of rig owners are understood to have shown interest in the tender for work at the Beatrice, Galley and Tartan fields. In addition Dea (formerly RWE Dea) is seeking a semi for four wells at Zidane in the Norwegian sector.

The last month has seen a slight pickup in rig tendering activity. Admittedly the majority of this has come from operators looking to retender for existing rigs on contract hoping to secure lower rates or southern sector jackup work. But many are saying that this 'more for less' theory might just come to fruition after all. As costs for drilling have been slashed since the start of this downturn, there lies some real opportunity out there to secure amongst other things rig capacity at greatly reduced rates.

MARIA PDO SUBMITTED

Wintershall has now submitted the official plan of how the Maria field will be developed. Twenty kilometers west of the Kristin field in the Norwegian sector, recoverable resources are expected to come in at around 180million boe. The plan involves two subsea templates which will be tied back to several platforms in the area namely Kristin, Heidrun and Asgard B. We reported last month that Wintershall was looking for a semi to drill the production wells at Maria commencing second half of 2016. Production from Maria is set to start late 2018.

WHO'S RIGHT? FINANCIAL MARKETS OR OWNERS?

BY ALEXANDER ALBERT

Over the past year the values of the listed offshore shipping companies in Norway have undergone dramatic changes in share prices. On average equity values have tumbled 60%. Interestingly however, the book value (i.e. the value of the assets – in this case the ships minus the amount of debt) has stayed the same, or even increased. The discrepancy between equity value of the company and book value of the assets is now a staggering 74%.

Company	Market Value Equity (04.05.15)	Book Value Equity (31.12.14)	Market value as % of book value
Siem Offshore	1019	6287	84 %
Solstad Offshore	1889	5058	63 %
Eidesvik Offshore	509	2125	76 %
Farstad Shipping	1478	6625	78 %
Deep Sea Supply	1045	3380	69 %
Rem Offshore	834	2335	64 %
Havila Shipping	312	1956 (Q1-15)	84 %
Numbers in NOK millions		Average	74 %

SOURCE - OSLO BØRS & ANNUAL ACCOUNTS

Total outstanding debt is fairly easily to calculate so the only thing left in doubt is the valuation given to the vessels. So who is right? The market or the owners?

The common practice in ship value appraisals has been to use broker estimates, benchmarking against last sales in the market or willing buyers , as well as newbuilding cost. Hence, book values are likely to be arrived at using any or a combination of the above methods. But, is this fair practice?

For years it has been common for ship values to remain above newbuild prices even after years of trading and irrespective of market conditions.

Now however, the market has gone into a serious downturn characterized by oversupply of tonnage, decreasing contract coverage and a dire outlook for the coming years. Why then, should a ship retain its value, if it currently can't even attract high enough rates to cover OPEX? More importantly, when the supply of ships increases above the demand for ships, wouldn't that also imply a decrease in value?

To understand why assets are likely to be overvalued, and that some of the common valuation practices could be flawed, we must use a different approach.

In corporate finance, the common way to arrive at an objective valuation is using a method called present value discounting. In theory it's fairly easy to arrive at, although it assumes the factors that play into what makes your valuation are reasonably accurate. With the case of a ship, the expected future free cash flows to the ship owner are to be discounted by a certain discount rate. Simply taking the expected daily rate for X amount of years minus operating costs, and given a terminal value at the end of the projected earnings period.

Using this approach based on current outlook for dayrates would likely imply a significantly lower value than what we are seeing today.

SOMETHING'S GOT TO GIVE

With such large difference between market value and book value a shift of one of the two is on the cards. This can happen with an increased interest in shares in the company pushing the market value up as investors see an opportunity to pick up 'cheap' shares in a company with valuable assets. Or it could mean that auditors looking at accounts for these companies begin to question the validity of these asset values. This could put pressure on those giving the valuations – and this is something we are beginning to see, a creeping sentiment in the market the valuations should be lower than they actually are.

The repercussions of a reduced value of assets – particularly in relation to level of debt an owner has could take a company into murky territory. Loan covenants stipulate the maximum level of debt in relation to value asset value, if this changes significantly being in breach of the terms of the loan can become a real problem.

DISTRESSED SALES

THE VULTURES ARE CIRCLING

BY ALEXANDER ALBERT

As a daily observer of the North Sea spot market it's clear that a disequilibrium in the market has manifested itself. It is common in most industries to observe varying degrees of mismatch between supply and demand, although in capital intensive industries such as offshore shipping the consequences can be harsher and prolonged.

A common denominator for capital intensive businesses is the higher ratios of debt to equity compared to other industries. With the need for debt to finance asset purchase comes ways for creditors to lower their risk. A way of doing this is to put in place covenants, with the most common being collateral maintenance covenants and cash reserve covenants. The first relates to the outstanding loan balance to remain within a certain range relative to the assets (ships) fair market value. Secondly, creditors might stipulate a certain amount of cash to remain at hand, often as a percentage of current years down payments.

As dayrates continue to be put under pressure in the spot market, and vessels being fixed on term contracts below their daily OPEX, it is expected that owners will eventually enter into periods of cash flow constraints/difficulties. In this case, it might be harder to refinance, or eventually it might lead to a breach of loan covenants. Ultimately this can lead creditors to force a sale in order to secure their position. As this happen to several companies at once, a wave of distressed sales and a lack of willing buyers can force the market value of ships to decrease significantly as everyone is heading out through the same door. Inevitably one breach of a covenant leads to another.

When the market hits bottom and no traditional buyers are left and financing is all dried up, the untraditional players enters the market*. HiTechVision, a private equity fund specializing in upstream offshore oil and gas bought up Troms Offshore some years ago at a growth stage in the company. After a cash injection and an operational overhaul the company was sold and a successful exit achieved.

What we now expect however is the opposite of that. Instead of entering at the growth phase of a company, hedge funds and private equity firms will seek to seize on struggling companies where gains can be made as owners approach the wall. We are already seeing signs of this as DOF`s Brazilian subsidiary Norskan sold five of their vessels to a local private equity player. Though this is not necessarily a sign of DOFs struggles but merely a growing interest from untraditional players in offshore assets.

Interestingly however, a US based hedge fund has acquired a significant stake in Gulfmark Offshore. After a 60% decline in stock price over the last year this new investor seems to signal that they believe the bottom has been reached.

We are of the impression that the North Sea is not quite there yet, although we are seeing the seismic industry facing difficulties which is usually the first to get hit. When, and not if, vessels valuation will take a significant haircut, and cash flows takes a beating, the circling vultures will start to pick off the weak.

*Untraditional players defined as non-shipping related companies, in this case investors as the likes of private equity, hedge funds or other investors. Common among them is investing private funds in companies with untapped values/ potential.

SIEM CONTRACTORS SECURES GERMAN SECTOR WORK

Siem Offshore Contractors has been awarded the turnkey contract for supply and installation of the inner array grid cable system for the Veja Mate offshore wind farm located. Veja Mate is located 115km off the German coast within the German Bight sector of the North Sea. Siemens will supply the 67 turbines to be installed by Siem Offshore Contractors utilizing the fleet of vessels from the Siem Offshore Group. The field is expected to be brought online before the end of 2017

DANTYSK OFFICIALLY OPENED

The latest European wind farm was officially opened this month, the DanTysk farm located 70km west of the German Sylt Island. The field has been jointly developed by Vattenfall and SWM and comprises 80 Siemens turbines with a combined capacity of 288MW. The two companies will be continuing work together with the expansion of offshore wind potential in the Sandbank sight near to Dan Tysk. The Sandbank wind farm will utilize a capital investment of EUR 1.2 billion with construction commencing summer 2015.

LAYING FOUNDATIONS AT KENTISH FLATS 2

Vatenfall's extension to the existing Kentish Flats field has reached another milestone this month as the Geosea jackup vessel Neptune prepares to install foundations. The vessel arrived onsite and the first of two foundations will shortly be installed, work will continue on this for a few weeks according to Vattenfall. The field is located off the South East coast of England and will consist of 15 turbines totaling 49.5MW of capacity. As mentioned this is an extension to an existing field which has been generating power since 2005. The original Kentish Flats field contains 30 turbines with a capacity of 90MW.

The rapid advancement in technology that the offshore wind industry has undergone is evident here. While it is common knowledge that new fields are being planned further from shore and in deeper water, the technology available to generate increased amounts of power from fewer turbines is playing a huge part in making this industry an attractive solution for energy provision.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